



Global stock markets, similar to this past October, are experiencing volatility driven largely by geopolitical events in China, North Korea and the Middle East. The markets are also reacting to signals of a potential global economic slowdown. From a fundamental perspective, U.S. corporate balance sheets are strong with companies holding near record levels of cash, consumer balance sheets are strong and the employment level in the economy continues to improve. Just yesterday, the ADP Employment report noted 'unusual' strength is anticipated for Friday's Employment Situation Report. The ADP report noted a 257,000 increase in payrolls versus expectations of a 190,000 increase. The ADP report does have a mixed track record in forecasting the Friday Employment Situation Report; however, last year's November report accurately forecasted what turned out to be a strong job report on the subsequent Friday.

One aspect of the recent volatility is the prospect that we are in the "late stages" of the economic cycle. This may be accurate, but we do not believe we are at the end of the current expansion or at a point where the economy is eminently headed for a recession. Compounding the market vulnerability is the weak performance of manufacturing and commodity producing sectors. We acknowledge a bifurcated U.S. economy, where the aforementioned sectors of the economy are doing poorly, while, the consumer side of the economy is doing reasonably well. We see a good deal of positive economic activity related to consumer demand, automotive shipments, and the housing sector. Importantly, we are a consumer led economy where manufacturing represents 12-13% and consumer and services represent the other 85%.

The retail landscape is experiencing volatility much like the market. Company reports have been mixed over the past several months with various reasons for pockets of weakness, including unseasonably warm weather, which resulted in modest cold weather apparel sales. There are certainly demographic shifts occurring as to how and where people spend, including the growth of online retail and the shift to purchasing 'experiences' rather than physical goods. Importantly, the retail industry recently announced same-store sales figures should likely beat forecast expectations.

As we look at corporate earnings expectations, we note some of the headwinds from last year should not be as great a negative influence on company earnings in 2016. Specifically, the headwinds from the sharp drop in oil prices and the strength in the U.S. dollar. Expectations for U.S. corporate earnings in 2016 are a mid-teens increase versus 2015. Admittedly, the strong earnings growth is predicated on an improving, or not worsening, energy environment. We believe earnings growth expectations may be on the high side; however, should we realize even more muted growth, the U.S. stock market should be able to produce reasonable returns for 2016.

Based on a number of recent decisions, led by our investment process, our client portfolios have limited to no recent exposure to traditionally more volatile asset classes. This includes: U.S. small cap equity, emerging market equity and high yield bonds. Additionally, we have a much higher level of cash than we would normally hold. The allocation within the bond segment is defensively positioned and consists mostly of higher quality fixed income investments with a shorter-term maturity profile.

This heightened volatility may be an opportunity to add to high-quality investments selling at discounted prices. We similarly used the August/September period to do this. While it is difficult to predict how much the markets might correct, we believe the backdrop for continued equity gains remains over the intermediate term.

If we can answer any questions or you have specific thoughts, please do not hesitate to contact any of us at HORAN Capital Advisors.